

## Yellen's First Trial and Error

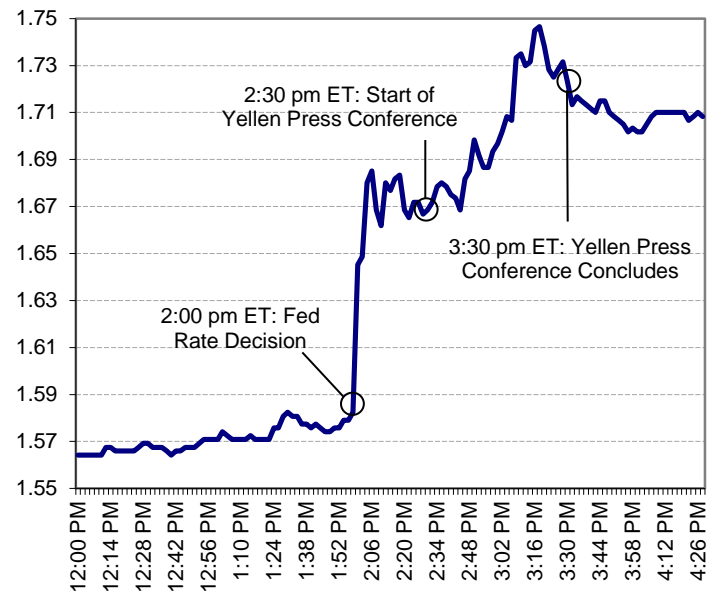
Fed Chair Janet Yellen convened her first meeting of the Federal Open Market Committee followed by her first post-meeting press conference on Wednesday afternoon.

Notable changes to Fed statement and outlook:

- Removed 6.5% unemployment rate threshold, language remains vague
- Partially attributed recent economic weakness to weather
- Fed participant projections for timing of next rate hike shifted slightly sooner

Notable market reaction:

- On the release, rates moved higher across the curve, most severely for 3- and 5-year UST maturities. Equities sold off as well.
- During the press conference, markets seized on what may have been inadvertent speculation on Yellen's part. When asked how long after the end of tapering (expected to end this fall) would the Fed then look to raise rates, a portion of her response included "something on the order of six months, or that type of thing." This would put rate hikes sooner than traders previously believed. Rate and equity markets instantly sold off more violently (US Treasuries effectively doubled their losses in the minutes following her comment), eventually bouncing back slightly into the close.



**Fig. 1** Wednesday afternoon's 5Yr US Treasury yield volatility before, during and after the FOMC rate decision and press conference

Source: Bloomberg

Caprin's take:

Under the intense spotlight of her first meeting, Yellen provided what, at first listen, sounded like a timeline for raising its target rate. With the Fed's removal of the quantitative unemployment rate threshold, the market seemed thirsty for such qualitative guidance. The market reaction may have been more than she intended or anticipated.

In our review of the Fed's language and the big picture that we believe Yellen tried to paint, we do not believe today's events demand a meaningful revision to our expectation for the Fed's rate path. We see upward pressure on rates as the Fed further reduces its role in US markets, but still do not see sufficient economic velocity to generate rate-spiking levels of inflation. We believe the bulk of today's reaction was the result of being caught off-guard by Ms. Yellen's choice of words, words she may choose more carefully as she learns the demands and pitfalls of the Chairmanship.